CITY OF LINCOLN
POLICE & FIRE PENSION ADVISORY COMMITTEE MEETING
3:00 P.M., THURSDAY, NOVEMBER 7, 2002
POLICE CONFERENCE ROOM

Members present:	Aaron Drake, Jim George, Mark Westphalen, Joe Yindrick, Mark Meyerson, Michael Donnelly,
Members absent:	None
Personnel Dept. Resource Staff:	Georgia Glass, John Cripe, Paul Lutomski
Others present:	Police Sergeant Sorensen, Fire Fighter Todd Dondlinger, Fire Union President Mark Munger, Mayor's Chief of Staff Mark Bowen.

Aaron Drake: Welcomes all present to the meeting. Asks Paul Lutomski to present recent activities.

Paul Lutomski: Apologizes for an error in a letter sent to committee members on October 14, 2002. The letter stated the committee approved a 10% alternative asset allocation when it should have said a they approved a 5% allocation.

We would like to concentrate on two investment items today: The JP Morgan Multi Strategy Fund and the Smith Hayes Capital 20 Fund. I have asked representatives from JP Morgan to call at 3:30 to answer questions, so I would like to begin by discussing that investment.

Paul verbally reviews a letter mailed to the committee members on October 13, 2002. The pertinent text of that letter is reprinted below:

Begin Text from letter---

For the Fund-of-Hedge-Funds we had stated our criteria to be a multi-strategy multi-manager fund-of-hedge-funds managed from a large established company with at least 10 years experience. The fund-of-hedge-funds should include 10+ managers and at least five different styles, but even more diversification is preferable. We are also requiring a *hurdle rate*, *a loss carry forward provision* and audited accounting records. Finally, a higher level of liquidity is preferable.

> *A hurdle rate, or preferred return, is a rate that must be met before an incentive fee is paid to the fund manager. For example, as an incentive a manager could receive 5% of the profits above a 6% hurdle rate.*
>
> *A Loss-carryforward provision, or highwater mark, is used to recoup any investor losses before the manager is paid an incentive fee. Example #1: Assume a 6% hurdle rate, and a 2% loss in the first year. In the second year the fund would have to gain more than 14% (to repay the 2% loss, the 6% payable in the first year, and the 6% payable in the second year) before an incentive fee would be paid to the fund manager. Example #2: Assume a 6% hurdle rate. If the fund earned 10% in the first year, the manager would be paid an incentive fee. If the fund lost 2% in the second year, the manager would not repay any of the first year's incentive fee, but would have*

to gain more than 14% in the third year – per the first example – before being paid an incentive fee.

J.P. Morgan Alternative Asset Management and the Tremont Advisors Inc, an Oppenheimer Funds Company was contacted because they met our criteria of a "manager from a large established company with at least 10 years experience in managing a fund-of-hedge-funds available to institutional investors."

Each manager has supplied a package of information and we have spoken extensively with representatives from each manager to clarify our understanding and develop this comparison. We have created a "Risk/Return Analysis" spreadsheet/graph comparison of the funds. These materials are enclosed.

<u>The Fund-of-Hedge-Funds under consideration are:</u>

J.P. Morgan **Multi Strategy Fund I** (redemptions, A shares :quarterly, B shares: annually)
Oppenheimer/Tremont **Market Neutral Fund** (quarterly redemptions)
Oppenheimer/Tremont **Opportunity Fund** (quarterly redemptions)
Oppenheimer/Tremont **Multi-Tech Fund** (quarterly redemptions)

We eliminated Oppenheimer/Tremont **Multi-Tech Fund** because it does not have a multi-strategy approach. It employs a long/short equity strategy concentrated on the technology sector.

<u>Expense structures of the remaining funds.</u>

These three fund-of-hedge-funds expenses consist of a management fee, and a hurdle rate incentive fee linked to a loss carry-forward provision.

The **Market Neutral Fund** has a 0.9% of average assets management fee payable regardless of performance. It has a hurdle rate equal to the 2 year Treasury Note rate (about 1.8%). The manager is paid an incentive fee of 0.25% of average assets if the return is equal to or greater than the high-water mark. Any losses, or earnings less than the hurdle rate, must be caught up before the manager is paid the incentive fee.

The **Opportunity Fund** has a 1% of average assets management fee payable regardless of performance. It has a hurdle rate of 8%. The manager is paid an incentive fee of 10% of the earnings above the hurdle rate. Any losses, or earnings less than the hurdle rate, must be caught up before the manager is paid the incentive fee.

The **Multi Strategy Fund** has two classes of shares. Class A shares, which allow quarterly redemptions, have a 1.6% of average assets management fee payable regardless of performance. Class B shares, which allow annual redemptions, have a 1.25% of average assets management fee payable regardless of performance. Both classes of shares have a hurdle rate of 6%. The manager is paid an incentive fee equal to all of the next 0.3% of earnings above the hurdle rate and 5% of the rest of the earnings above the hurdle rate. Any losses, or earnings less than the hurdle rate, must be caught up before the manager is paid the incentive fee.

To view the original documentation on the expense structure of the funds, see the following pages of the material:

- Oppenheimer/Tremont **Market Neutral Fund** on page 8 of their brochure.
- Oppenheimer/Tremont **Opportunity Fund** on page 9 of their brochure.
- J.P. Morgan **Multi Strategy Fund** on page 27 of their brochure.
  (Management fee of "A" shares is 1.6% and "B" shares is 1.25%)

Below are charts showing account values at various hypothetical return rates. The return rates of 8%, 10% and 12% were chosen because they roughly match the 3 year average annual returns (ending August 30, 2002) for the Market Neutral, Opportunity and Multi Strategy funds respectively.

Year	Return	Market Neutral	Opportunity	Multi Strategy A shares	Multi Strategy B shares
1	8%	$1,067,940	$1,069,600	$1,059,510	$1,063,150
2	8%	$1,140,496	$1,144,044	$1,122,383	$1,130,098
3	8%	$1,217,981	$1,223,670	$1,188,809	$1,201,074
4	8%	$1,300,731	$1,308,837	$1,258,988	$1,276,318
5	8%	$1,389,102	$1,399,932	$1,333,134	$1,356,089

Year	Return	Market Neutral	Opportunity	Multi Strategy A shares	Multi Strategy B shares
1	10%	$1,087,800	$1,087,500	$1,078,350	$1,082,025
2	10%	$1,183,309	$1,182,656	$1,162,604	$1,170,532
3	10%	$1,287,203	$1,286,139	$1,253,206	$1,266,033
4	10%	$1,400,220	$1,398,676	$1,350,635	$1,369,082
5	10%	$1,523,159	$1,521,060	$1,455,405	$1,480,273

Year	Return	Market Neutral	Opportunity	Multi Strategy A shares	Multi Strategy B shares
1	12%	$1,107,660	$1,105,400	$1,097,190	$1,100,900
2	12%	$1,226,911	$1,221,909	$1,203,534	$1,211,678
3	12%	$1,359,000	$1,350,698	$1,319,895	$1,333,301
4	12%	$1,505,310	$1,493,062	$1,447,216	$1,466,832
5	12%	$1,667,371	$1,650,431	$1,586,529	$1,613,434

Risk and Return structures of the funds.

This analysis began by obtaining monthly returns for each fund from the fund managers. The monthly returns are on page two of the stapled "Risk/Return Analysis." The **Market Neutral Fund (II)** currently available to investors began its return history in November 2001. Prior to that displayed returns (highlighted in gray) are attributable to the Market Neutral Fund (I). For details please refer to disclaimer #3 on this fund's Performance Update sheet in the back pocket of the American Masters (Oppenheimer/Tremont) folder.

The **Opportunity Fund (II)** currently available to investors also began its return history in November 2001. Prior to that displayed returns from October 2001 back to June 2000 (highlighted in gray) are attributable to the Opportunity Fund (I). Returns prior to June 2000 are hypothetical "Back tested" returns. For details please refer to disclaimer #3 on this fund's Performance Update sheet in the back pocket of the American Masters (Oppenheimer/Tremont) folder.

The **Multi Strategy Fund (I) Offshore** currently available to investors also began its return history in April 1995.

The monthly returns were used to check the returns, standard deviations and Sharpe ratios published by the fund managers. This data for the **Market Neutral** and **Opportunity Funds** are displayed on their respective "Performance Update" sheets. The monthly return data for the **Multi Strategy Fund** is printed on page 18 of their brochure (the July and August returns were obtained by telephone) and the Sharpe ratio is printed on the second page of the stapled document. An updated Sharpe ratio through the end of August was obtained by telephone.

A discrepancy was discovered in the figures for the **Opportunity Fund**. Further investigation lead to the admission from Steven Jupta, of Tremont, that the published Standard Deviation and Sharpe ratios were incorrect. He stated the Standard Deviation was based on four years of monthly return data (ending June 2002) rather than three years of data as published. (Also remember that monthly return data prior to June 2000 was hypothetical), and that the Sharpe ratio was too high. He estimated it should correctly be 1.39% rather than the published 2.5%.

Page four of the Risk/Return Analysis displays pension administration's calculated Annualized Return, Annualized Standard Deviation, and Sharpe ratio and a scatter plot of Annualized Return and Annualized Standard Deviation. When analyzing hedge funds it is widely accepted that the Sharpe Ratio is the best measure of Risk/Return performance. A high Sharpe Ratio is better than a lower one. The scatter plot shows the **Market Neutral Fund** as having the lowest Annualized Standard Deviation (a commonly used measure of risk), but the **Multi Strategy Fund** has the highest Annualized Return and best Risk/Return performance via the Sharpe Ratio. (We also have higher confidence in this fund's monthly return figures as none are back tested hypothetical numbers)

The **Opportunity Fund** was eliminated because of it's high Annualized Standard Deviation, and resultant low Sharpe Ratio.

The comparison now concentrates on the **Market Neutral Fund** versus the **Multi Strategy Fund**.

The **Multi Strategy Fund** has a higher three year average return, and a higher Sharpe Ratio than the **Market Neutral Fund**. (Refer to the Risk/Return Analysis)

The **Multi Strategy Fund** is organized as an "offshore" fund specifically to avoid UBTI, (Unrelated Business Taxable Income) but the **Market Neutral Fund** is a domestically domiciled fund. As such it subjects its investors to UBTI – which the Police and Fire Pension wants to avoid for the following reason:

UBTI, Unrelated Business Taxable Income, is a concern to tax exempt investors in a hedge fund because the receipt of UBTI requires the tax exempt entity to file a tax return that it would not otherwise have to file and pay taxes on income that would otherwise be exempt, at the corporate rate. UBTI includes most business operations income and does not include interest, dividends and gains from the sale or exchange of capital assets. Hedge Funds trade their own securities and therefore the tax exempt investor's share of such income of the hedge fund is not UBTI and not subject to federal income tax. However, hedge funds may subject tax exempt entities to UBTI under certain circumstances where the hedge fund is borrowing or purchasing securities on margin. Such transactions may subject the tax exempt to UBTI tax. Generally, tax exempt investor entities prefer the offshore investment company (possibly the feeder fund) to avoid UBTI tax.

The bolded items in the table below show the **Multi Strategy Fund** is larger ($1.9B vs. $65M) and has more managers (35 vs. 16) than the **Market Neutral Fund**. Its larger size and higher level of diversity add stability to its risk/return structure.

Topic	**Market Neutral Fund II**	**Multi Strategy Fund I (Offshore)**
Total Assets under mgmt in all funds	$8 billion	$ 4 billion
Assets under mgmt	**$ 30 million ($65 million in the MNF I that PF Pen could also invest into)**	**$1.9 billion**
Managers Years of Experience	18	12
Number of Staff	85	54
Other public entities invested in this fund	Texas State Teachers, YMCA, University of Virginia, Daimler Chrysler	Can't give out client names, but said they manage $253 million in public fund assets.
Types of strategies employed	**Equity Market Neutral Long/Short Equity Convertible Arbitrage Event Driven Global Macro Fixed Income Arbitrage From "Performance Update"**	**Long/Short Equity Merger Arbitrage/Event Driven Opportunistic/Macro Relative Value Distressed Securities Short Selling From third page of stapled document**
Total number of mangers in all funds	120	73
Number of managers in this specific fund	**16**	**35**

The **Market Neutral Fund** was eliminated because the prior comparisons favor the **Multi Strategy Fund** regarding Return, Sharpe Ratio, UBTI, assets under management and manager diversity.

Recommendation: Purchase $1,000,000 of J.P. Morgan Multi Strategy Fund "B" shares each quarter for four quarters. ($4,000,000 is 3% of current total assets.)

End text from letter --

Representatives of JP Morgan call at 3:30. The speakerphone does not work so Paul acts as intermediary for questions and answers.

Michael Donnelly: I'm not comfortable with funds not domiciled in the U.S.

JP Morgan: Our tax exempt customers use offshore domicile to avoid paying U.S. taxes on UBTI. It is a common practice in this type of investment. The offshore domicile is attractive to international investors also for tax reasons. We don't have U.S. tax exempt investors in domestic domiciled funds.

Michael Donnelly: What is the history of UBTI on this fund? What portion of the return is from UBTI? What is the minimum amount that would require filing tax for UBTI?

JP Morgan: We don't calculate UBTI on this fund since it is not applicable to it. We would not advise a tax exempt to invest in a fund with UBTI. Paying tax on UBTI effectively lowers your returns by the tax amount. I don't know the amount of UBTI that would require a tax form to be filed.

Michael Donnelly: If I had my choice I would prefer to domicile my assets in the United States. Where are the securities held?

JP Morgan: The assets are held by the prime broker used by the individual fund managers. Some are in the US and some are not.

Mark Westphalen: I asked this same concern to an analyst at Edward Jones headquarters and they said no. You will find a lot domiciled in the Caymen Islands. Foreign investors will not come into the United States as it subjects them to U.S. tax. They were not worried. This was the way they are normally structured throughout the industry.

Michael Donnelly: Can the assets be frozen since they are outside the United States? It would probably never happen. Its just another layer of risk.

JP Morgan: I couldn't imagine a situation where that would happen.

Mark Westphalen: How much leverage is used in the fund?

JP Morgan: On average, 1.7 to 1.

Jim George: Normally when you increase return expectations you increase risk, but we are being told to expect higher returns and lower risk at the same time. How is that possible?

Paul Lutomski: These investments are allocated in strategies other than those currently used by the pension. They are not closely correlated with the stock and bond markets and move independently of them. This adds diversification and that lowers risk in terms of price fluctuation.

JP Morgan: For example, in September the MSF was up 0.8% and the equity markets were down 12%. In October the MSF was down 0.2% and the equity market was up 11%.

Michael Donnelly: Is there a required commitment to any of the strategies?

JP Morgan: No, they have general guidelines, but the allocations are based on probable success of the strategies which are based on economic outlook and because the managers performance and receptiveness to new investments. Historically, the allocations have not changed too much, other than the recent elimination of an emerging markets strategy. The long/short and relative value strategy is the largest allocation and varies between 22% and 25%. Merger Arbitrage allocation has recently been decreased because opportunities have been scarce.

Mark Westphalen: How many people at JP Morgan are in a managerial capacity? Can we get bios on them?

JP Morgan: 54 in the group with 17 managers. I can send the 17 bios.

Greg Sorenson: Any litigation?

JP Morgan: No one is in court against JP Morgan Alternative Asset Management, but they are in court against a former hedge fund manager.

JP Morgan Question and Answer session ends. Return to active meeting.

Mark Meyerson: Where is this investment on the risk continuum?

Paul Lutomski: On page three of the Risk/Return Analysis there is a graph showing the Multi Strategy fund as having a annualized standard deviation of less than 5% and a an annual return around 12%. Compared to the NASDAQ with a standard deviation of 45% and a return of negative 25%. Other asset classes are shown such as the S&P 500 and Lehman Bond index. These investments were initially made for wealthy individuals. Their goal is not to get rich, they are already rich, their goal is never to be forced to go back to work. Therefore these investments pay as much attention to limiting downside loss as they do to upside gains.

Mark Meyerson: The few Police members I have contacted me felt it was very risky. They want to know why we would do this rather than invest more in mutual funds.

John Cripe: An individual doing this is risky, but buying into multiple strategies with multiple professional managers is not a single wager and diversification is increased and risk is reduced. This is not an investment for a normal individual investor. The minimum investment is $500,000 and only high net worth investors are allowed. I would agree that this is too risky for an individual investor, but that’s not what we are doing.

Michael Donnelly: The approach reduces risk. Individually these investments are higher risk than a stock fund, but collectively I don’t think that is the case. This is an attractive investment for a small portion of a big pension fund. The minimums and net worth requirements are designed to keep out those small investors out of these types of funds.

Mark Meyerson: Do you think this is a good investment for our pension fund?

Michael Donnelly: Yes. It is reasonable for the 3% allocation we are talking about. I would probably stretch out the purchases for more than four quarters.

John Cripe: By investing quarterly and having a one year redemption constraint we will have money available for withdrawal every quarter if necessary.

Michael Donnelly: I understand. That makes sense.

Mark Meyerson: Where is the money coming from to make these purchases.

Paul Lutomski: We have $20 million of Treasury STRIPS. We plan to sell $5 million for these investments. the STRIPS were purchased in 1992-93 and interest rates have gone down since then. This may be near the low. If rates go up we lose our unrealized gains in these STRIPS. By selling them we lock in that gain and reinvest in something with a higher future return potential. We are watching rates closely.

Jim George: Mark, what is your opinion?

Mark Wesphalen: I called Edward Jones headquarters. They were concerned about how much leverage was used. This amount of leverage is okay. They like the fund of fund approach for diversification. I don’t have a problem with it. I think it will add exposure to strategies that our other investments don’t have. I don’t think it can hurt us. The only other concern I had was if the market turns around, is this the type of investment you want. That question was answered from the return figures. Back in 1999 when the market was running up, these investments were also making money. I don’t have a whole lot of concern and being domiciled offshore doesn’t bother me either.

Mark Meyerson: How does the management fee compare to a mutual fund.

Paul Lutomski: It is less than the average aggressive growth mutual fund per Morningstar.

Mark Westphalen: I would say its probably twice the fee of the American Funds you are in, but I wouldn't let that bother me.

John Cripe: We have a loss carryforward provision and a hurdle rate that has to be met before their incentive fee is paid.

Jim George: "I make a motion that we follow the recommendation that the plan advisor has laid out for investing in the JP Morgan Multi Strategy Fund."

Aaron Drake: Second?

Mark Westphalen: "Second."

Aaron Drake: Discussion? All in favor?

ALL: Aye.

John Cripe: Next is the Smith Hayes Capital 20. For the concentrated long equity fund we like a product that implements the strategy employed by Standard and Poor's to create their "Neural Fair Value 20 Portfolio." S&P uses a "neural network" artificial intelligence to refine their quantitative stock ranking system to filter stocks and select those stocks 20 stocks identified as having the greatest potential for short-term price appreciation. The filter is done each week on Tuesday. There may be no changes, or a lot of changes each week. The returns are attractive and the strategy is straightforward. Smith Hayes Financial Services has created a portfolio using Standard and Poor's recommendations. Paul can give you details on the fee.

Paul Lutomski: The management fee is 1.65% annually. Smith Hayes runs the fund. Costs they incur to do so are:

S&P NFV 20 reports	$ 1,100 annual
Use of S&P Name	$ 2,500 annual
Legal work	$ 20,000 initial
	$ 4,000 annual
Printing and postage	$100,000 initial
	$ 10,000 annual
CPA Audit	$ 8,000 annual
Produce K-1 (IRS document)	
Software program	
Outside consultant calculation of quarterly performance	$ 4,000 annual
Transaction commissions	
Brokerage commissions	
Firm compensation	

Return numbers for this methodology were created by S&P back to 1987. We give more credence to these hypothetical returns, than the hypothetical data created by the hedge funds, because this methodology is implementing a ranking system rather than choosing managers. From 1987 the annual returns were 3.6%, 33.6% 36.2% -7.6%, 23.6%, 18.3%, 24.9%, -3.7%, 51.2%, 29.9%, 54.7%, 48.9%, 46%, 19.07%, and 29.71% in 2001. You would need to subtract 1.65% from each year for the management fee, and the Smith Hayes fund would also vary because they would have to buy and sell during the day on Tuesday and those figures use the closing price Tuesday evening as the buy and sell price. We like the system. It is very structured. They are implementing a system S&P developed over years. S&P looked at several different sets of buy/sell rules and number of stocks to keep in the portfolio.

They chose this method as the best. A neural network is a type of artificial intelligence that tries to mimick a human brain. Our brains are not sponges, they are filters. The system would have many inputs and one known output. The importance of the inputs, and how they are combined, are varied through a funnel like honey comb layered system for hundreds of iterations until the inputs consistently yield a decision equal to the known outcome. Once the system is designed using historical data, new data can be input and it should give an answer that has a high probability of matching the future real outcome. What was your other question?

Mark Meyerson: The Smith Hayes fund only holds 20 stocks at one time. Isn't that risky?

Paul Lutomski: Yes. It is a concentrated, not diversified, equity fund. It has had good returns, and we are only investing $1 million. That's 0.8% of total assets.

John Cripe: The methodology takes the emotion out of it. The top 20 list I saw indicated removal of Harley Davidson. HD has had a tremendous run up in the past few months and they must think there are better stocks. I'd keep it. There is no emotion in the program.

Mark Meyerson: This is not what you would call a diversified investment.

Paul Lutomski: Absolutely not. It's a concentrated equity fund.

Jim George: On page 5 they are comparing this to the S&P since 1987. How can they go back and do that when the fund was not running then.

Paul Lutomski: They probably had the non-neural stock rankings and then applied the buy/sell rules and neural decision making to those inputs. This is historical data I spoke of that was used to teach the neural system. Once the system was developed using those inputs they could go back and apply the system to see exactly which stocks it would have selected and then calculate the returns on that portfolio of stocks.

John Cripe: Smith Hayes is not making judgments either. They are just implementing the S&P system.

Jim George: That strategy has basically doubled the S&P 500 return.

Michael Donnelly: Their initial offering amount was $3 million.

Paul Lutomski: They now have $4.2 million and about 17 investors.

Michael Donnelly: What about the ERISA concern?

Paul Lutomski: I talked to Bill Shreve and Matthew Maude about that. There is a paragraph in the middle of page 21 about ERISA co-fiduciaries. The example they gave was if they had a 401K plan from Company A and the Smith Hayes Cap 20 was an investment option and an employee invested in it and then it tanked. If the fund has more than 25% of its assets from ERISA sources, like 401Ks or IRA, the company providing the investment could be liable for poor performance. This employee in this example could sue Company A for offering the Cap 20 as a choice, but this paragraph is an attempt by Smith Hayes to make it so the employee couldn't sue them. It is not an issue if the ERISA asset percent stays below 25%. It is currently about 10% - from some doctors IRAs. Smith Hayes is not pursuing ERISA money and plans to monitor the percent. The PF Pension would not be affected by any of this even if the percent goes above 25%.

Michael Donnelly: What about the fee? Do they feel that they are earning the 1.65% management fee? This is not an active fund. I question if 1.65% is justifiable, but its not that high.

Paul Lutomski: I called them and discussed your concern. If we were to do this ourselves, which we don't want to do because then John and/or I could never take vacation on a Tuesday again, it would cost between $10,200 and $17,300 depending on share transaction prices and usage fee paid to S&P.

<u>PF Pension Costs</u>

S&P NFV 20 reports	$ 1,100 annual
Annual S&P Usage fee	$ 35 to 50 bp of amount invested

(S&P contact Richard Gandon 1-800-221-5277 Smith Hayes did not have to pay this because they started their discussions with S&P before S&P developed the fee structure for use of the NFV 20 and because Smith Hayes uses/pays S&P as their primary research entity)

Discount brokerage commission

$0.10 to $0.05/share for good execution so you can confirm over telephone with an actual person. (Charles Schwab)
Average share price $25
Average turnover 140%
@$0.10, $5600 *2 = $11,200
@$0.05, $5,600

$17,300 max
$10,200 min

My concern was executing the trade at a fair price. What if a lot of people are following this system and they all trade on Tuesday and a stock has a low volume. I think Smith Hayes, because of their larger size, could get the trades executed better than we could.

Michael Donnelly: They are going to make some big money on this thing.

Paul Lutomski: When we talked about this before the meeting I asked if Wells Fargo could do this on $1 million for 1.65% and you said probable not.

Michael Donnelly: No. On $1 million we couldn't. Your only alternative is to go to Smith Hayes and they're not willing to negotiate the fee?

Paul Lutomski: No. They just wanted to offer the security to us. They are neutral as to if we decide to buy it, or not.

Mark Westpahalen: I know S&P's neural ranking system. I have complete total confidence is S&P's ability to indicate if a stock is under or over priced. Every stock I trade I check S&P research. I had a client that wanted to buy A.O. Smith. I don't know anything about A.O. Smith other than they are a huge water heater manufacturer. S&P said it was significantly undervalued and had the highest possibility for a positive earnings surprise. He bought it and made money on it. I also give credit to the system because up until the beginning of this year there was not a technology based company on the top 20 list. I have complete confidence in the system. I may have some questions on how Smith Hayes is going to operate it, but that's above this conversation.

Mark Meyerson: (To Michael Donnelly) Do you think this is a good investment for our pension?

Michael Donnelly: I do. Wells Fargo is a value manager. This is an excellent way to deliver an alternative investment to the pension. It is a tremendous way to get into this alternative.

Mark Westphalen: My experience is that this fund will not perform well in a down market, but in an up market you will make money. I've had clients make 30% to 60%.

Jim George: "I make a motion that we follow the recommendation of the pension administration to invest $1 million in the Smith Hayes Capital 20 limited partnership in December 2002."

Aaron Drake: Second?

Mark Westphalen: “Second.”

Aaron Drake: Discussion? All in favor?

ALL: Aye.

Aaron Drake: Motion passes. Any new business?

Paul Lutomski: Mr. Donnelly completed Ross Hecht’s term on the committee. Georgia noticed his term expired. Mr. Donnelly has agreed to continue so we need to ask the City Council to reappoint him.

Jim George: Please comment on the letter Georgia sent out?

Georgia Glass: The reason Ross Hecht resigned was because we had strayed from the financial advisory purpose of this group, the reason he was interested in being on it originally. We were spending a lot of time talking about pension enhancements. We, and the Mayor’s Office, are more than happy to talk about pension enhancements with the unions. The purpose of this meeting is advice on finances and operations. As you saw a year ago the Mayor put together a task force to talk about pension enhancement, but it met separately. The intention was not to suppress discussion about benefit changes. We have always taken the position that pension is not negotiable in the annual labor union contracts. The mayor has never said his door was closed to discussions about the pension.

Aaron Drake: That is a non-structured environment. That has not worked in the past.

Georgia Glass: We can structure it.

John Cripe: This structure is a formal public meeting. It is not the appropriate structure for confidential pension discussions. I advocate a less formal structure.

Jim George: And do it in such a way that it will proceed regardless of who is Mayor.

John Cripe: We could do it by policy or letter of agreement by both unions. Then it doesn’t matter who the Mayor is. You could have whoever you wanted involved in the discussion. Don Jones (an actuary from Omaha on the Mayor’s task force) was very helpful.

Georgia Glass: I think it would be appropriate for the two union presidents to get together and talk about this.

Mark Munger: Or if we want to do it. I don’t need another meeting to be meeting and not being constructive and not moving forward. I don’t need just another meeting.

Aaron Drake: A new item. The level of knowledge of this group has increased over the last couple of years. We have moved from discussing very typical investments to move aggressive investments. A lot of that knowledge we have ascertained has come from the conferences we have attended. I would like to see that continue. In the past we have pleaded for some City funding. I would like bring up the idea of funding some additional trips. Possibly give the individual members, or the Police and Fire Unions, the ability to pick and choose conferences rather than sending us to just one. I think going to conferences should be a permanent role. Discussion?

John Cripe: I think they are invaluable. You are exposed to some good and some goofy concepts. The DROP and the PEHP plan are examples.

Georgia Glass: Just so you know, the directive from the Mayor’s Office was no travel of any kind regardless of funding source, but things are never that black and white.

John Cripe: We can do some checking and get back to you.

Aaron Drake: Meeting adjourned.